

**Letter Report: The Internal Revenue Service
Is Contributing to the Decline in TeleFile
Volumes**

October 2001

Reference Number: 2002-40-003

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

October 9, 2001

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Letter Report - The Internal Revenue Service Is
Contributing to the Decline in TeleFile Volumes

This report presents the results of our audit to evaluate: (1) whether decisions by the Internal Revenue Service (IRS) to discontinue mailing TeleFile Tax Record and Instructions (TeleFile packages) would contribute to taxpayers not using TeleFile and (2) whether the IRS had sufficiently determined the reasons eligible taxpayers were not using TeleFile. In summary, the IRS is contributing to the decline in the number of individual taxpayers using TeleFile.

As a cost saving initiative, the IRS decided to discontinue the TeleFile package mail-out for two categories of taxpayers. The first discontinued mail-out was for taxpayers that used a paid preparer in the previous year (beginning Tax Year (TY) 2000). The second discontinued mail-out beginning with TY 2001 will be for taxpayers that received the TeleFile package in the two previous years, but had not used TeleFile. These conditions may be contrary to the Congressional intent expressed in the IRS Restructuring and Reform Act of 1998 for the IRS to offer and improve the TeleFile Program. In addition, in an Electronic Tax Administration (ETA) program document for 2000, ETA had cited a potential near-term application of expanding TeleFile to its fullest potential use and to use it as a model product to enhance consumer acceptance of other Electronic Tax Administration programs.

We recommended that ETA management reverse its decision to discontinue mailing TeleFile packages to the two categories of taxpayers based on the Congressional intent for the IRS to offer and improve the TeleFile Program. We further recommended that the IRS identify TeleFile eligible taxpayers not using TeleFile and eligible taxpayers who stopped using TeleFile and conduct targeted surveys to determine the main barriers that prevent eligible taxpayers from using TeleFile. The information could then be used for specific outreach efforts to overcome the identified barriers.

The IRS did not agree with our recommendation to reverse its decision to discontinue TeleFile package mail-out because the IRS does not believe that it is cost effective or that our recommendation would result in program improvements. In response to our second recommendation, the IRS stated that the focus group results supported internal IRS studies (based on database analysis) that were a major component in determining the scheduled improvements to the TeleFile Program for the 2002 Filing Season.

While we still believe our recommendation is worthwhile, we do not intend to elevate our disagreement concerning it to the Department of Treasury for resolution. We have incorporated applicable IRS response information and our related comments into the report. We are including the full text of the IRS response as an appendix.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Stanley C. Rinehart, Acting Assistant Inspector General for Audit (Wage and Investment Income Programs), at (972) 308-1670.

Letter Report:
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Objectives and Scope

This review was conducted as part of the Treasury Inspector General for Tax Administration's (TIGTA) Fiscal Year 2001 audit plan. Millions of eligible taxpayers did not use TeleFile to file their Individual Income Tax Returns with the Internal Revenue Service (IRS). Therefore, we conducted this audit with two objectives.

- To evaluate whether decisions by the IRS to discontinue mailing TeleFile Tax Record and Instructions (TeleFile packages) would contribute to taxpayers not using TeleFile.
- To evaluate whether the IRS had sufficiently determined the reasons eligible taxpayers were not using TeleFile.

To accomplish these objectives, we evaluated information obtained primarily from the IRS Headquarters and the IRS Intranet. We analyzed the information to determine the basis and impact of the IRS decision to discontinue the mail-out of TeleFile packages for certain taxpayers. We also evaluated the information the IRS had pertaining to why TeleFile eligible taxpayers did not use TeleFile or had stopped using TeleFile. We conducted our review at the Fresno Campus from October 2000 through April 2001 in accordance with *Government Auditing Standards*.

Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List. Appendix III contains our Outcome Measures.

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Background

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)¹ states that one policy of the Congress is for the IRS to promote paperless filing. The long-range goal is to have at least 80 percent of all Federal tax and information returns filed electronically by the year 2007. However, in November 2000, the IRS projected that only 51 percent of the Individual Income Tax Returns would be filed electronically by the year 2007.

The Congressional intent expressed in RRA 98 was for the IRS to continue to offer and improve the TeleFile Program. The IRS function responsible for the TeleFile Program is called the Electronic Tax Administration (ETA). Part of the ETA function is to identify barriers that prevent taxpayers from filing electronically. In an ETA program document for 2000, ETA had cited a potential near-term application of expanding TeleFile to its fullest potential use and to use it as a model product to enhance consumer acceptance of other Electronic Tax Administration programs.

TeleFile only requires a touch-tone telephone and TeleFile is free.

TeleFile packages are sent to potentially eligible taxpayers based on their prior year return information including age, income, and dependent criteria. Some of the advantages of TeleFile are:

- TeleFile is an interactive program requiring only a touch-tone telephone that allows eligible taxpayers to file simple Federal tax returns with the IRS, 24 hours a day, 7 days a week. Filing returns using TeleFile takes an average of only 11 minutes and is completely paperless for the taxpayer.
- TeleFile is free. Taxpayers do not have to pay professional return preparation fees and do not have to purchase computers or tax software. This is important because TeleFile primarily includes lower

¹ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98), Pub. L. No. 105-206, 112 Stat. 685.

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income taxpayers. For example, for Tax Year 1998, almost 54 percent of the TeleFile taxpayers earned less than \$15,000.

Approximately 60 percent of TeleFile eligible taxpayers did not use TeleFile according to IRS statistics for Tax Years 1997 through 1999. This included approximately 7.5 million taxpayers for Tax Year 1999. For Tax Year 1999, approximately 5.2 million taxpayers used TeleFile to file their individual tax returns, down from approximately 5.7 million for Tax Year 1998 and 5.9 million for Tax Year 1997.

Results

The number of taxpayers using TeleFile is declining, in part, because of a change by the IRS.

The IRS has taken actions to reduce the cost of the TeleFile mail-outs, but these actions will result in the further decline in the number of taxpayers who are using TeleFile. These actions have been taken without contacting a sample of the affected taxpayers to determine why eligible taxpayers were not using, or stopped using, TeleFile.

The IRS Is Contributing to the Decline in TeleFile Volumes by Discontinuing the TeleFile Package Mail-Out for Two Categories of Taxpayers

The IRS decided to discontinue the TeleFile package mail-out for two categories of taxpayers. However, this could reduce the number of taxpayers using TeleFile by 690,000².

- Beginning with Tax Year (TY) 2000 TeleFile packages, the IRS discontinued mailing packages to

² All volumes and estimates in this TIGTA report are based on IRS ETA and Research Group (formerly known as the District Office Research and Analysis) documents without an independent verification by TIGTA.

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taxpayers whose prior year return had been prepared by paid individuals. This included over 6.6 million taxpayers for TY 2000 and the IRS estimated this reduced the number of taxpayers filing TY 2000 TeleFile returns by a minimum of 330,000.

- Beginning with TY 2001, the IRS plans to discontinue TeleFile package mail-out to taxpayers who had been eligible to but had not used TeleFile during the prior 2 years. The IRS estimates this will reduce the number of TeleFile packages mailed by over 3 million, and the number of taxpayers using TeleFile for TY 2001 by 360,000³.

The IRS did not give approximately 1 million "first-time" filers a chance to use TeleFile for TY 2000.

Included in the 6.6 million taxpayers previously mentioned were approximately 1 million taxpayers who had never been given the option of using TeleFile. Taxpayers have to file a "first" tax return before the IRS can send a TeleFile package to potentially eligible taxpayers. However, of the 6.6 million taxpayers who were excluded from receiving the TY 2000 TeleFile package, approximately 1 million filed for the first time for TY 1999. Consequently, the IRS never gave these taxpayers the chance to file their TY 2000 returns using TeleFile.

In addition, we were informed that the IRS had not surveyed taxpayers from these two categories to determine the reasons why taxpayers were not using TeleFile. In recent years, information from IRS initiated contacts with taxpayers regarding TeleFile non-use was available from two main sources, the annual vendor satisfaction surveys and March 2001 focus groups.

However, the 2 annual satisfaction surveys (with approximately 70 taxpayers in each year) and the focus groups (approximately 30 total participants in 4 metropolitan areas) had common drawbacks. These drawbacks included the small number of taxpayers

³ The 360,000 represents the number of taxpayers that would be impacted after eliminating the duplicates from the first category.

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contacted and sample results that cannot be applied to taxpayers nationwide.

The IRS stated the reason for wanting to discontinue TeleFile package mail-out for the two categories of taxpayers was that it would not be cost efficient because the IRS expected a relatively low participation rate.

As of April 2001, the IRS still planned to discontinue TeleFile package mail-out in subsequent years for these two categories of taxpayers. Taxpayers who do not receive a TeleFile package cannot use the TeleFile Program to file their returns. Taxpayers in future years that meet the criteria for these two categories will be prevented from receiving a TeleFile package.

Recommendations

1. Electronic Tax Administration management should reverse its decision to discontinue mailing TeleFile packages to the two categories of taxpayers based on the Congressional intent for the IRS to offer and improve the TeleFile Program.

Management's Response: The IRS stated that it would not implement our recommendation because it is not cost effective. In addition, the IRS stated that it did not believe that implementing our recommendation would result in program improvements.

Office of Audit Comments: The IRS response indicates that management recognizes that discontinuing TeleFile package mail-out to the two categories of taxpayers will prevent approximately 690,000 taxpayers from using TeleFile to file their returns. We believe that the IRS decision reduces IRS costs at the expense of taxpayer service. (Note: Using the IRS cost figures provided to us during our review, the cost would be approximately \$2.4 million instead of \$4 million.) TeleFile is free for eligible taxpayers, and is fast and paperless. Not implementing our recommendation will adversely affect taxpayer service by preventing an estimated 690,000 taxpayers in the two categories from using TeleFile to file their returns.

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In our opinion, the IRS decision will hinder the RRA 98 mandate because it contributes to the declining TeleFile volumes. As stated in our report, TeleFile volumes declined from 5.9 million to 5.2 million from TY 1997 to TY 1999. The IRS decision to discontinue TeleFile package mail-out contributed to an additional decline in TY 2000 by preventing an estimated 330,000 taxpayers from using TeleFile and will prevent an estimated 360,000 taxpayers from using TeleFile for TY 2001.

Finally, surveys and targeted outreach efforts to increase participation might result in increased TeleFile use that would make TeleFile package mail-out to the taxpayers in these two categories as cost effective as for other categories of taxpayers.

2. The IRS should identify TeleFile eligible taxpayers not using TeleFile and eligible taxpayers who stopped using TeleFile. The IRS should then conduct targeted surveys of sufficient scope (sample sizes, geographical locations, and relevant questions) to determine the main barriers that prevent eligible taxpayers from using TeleFile. The information could then be used for specific outreach efforts to overcome the identified barriers.

Management's Response: The IRS stated that the focus group results supported internal IRS studies (based on database analyses) that were a major component in determining the scheduled improvements to the TeleFile Program for the 2002 Filing Season.

Office of Audit Comments: We do not question the IRS' use of internal database analyses and the focus group results in attempts to improve the TeleFile Program for the 2002 Filing Season. However, the IRS response does not directly relate to our recommendation. Our recommendation pertains to the need for taxpayer contacts targeted to the major TeleFile non-use categories in addition to the two cited in our first recommendation, with specific outreach efforts for each category in attempts to overcome limitations keeping eligible taxpayers from using TeleFile. We do not believe that discussions with the approximately

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30 taxpayers in the focus groups and the approximately 70 taxpayers in the annual satisfaction surveys were sufficient to determine the main reasons why approximately 60 percent of TeleFile eligible taxpayers for TYs 1997 through 1999 did not use TeleFile. This included approximately 7.5 million taxpayers for TY 1999. We do not believe that IRS database analysis is a substitute for taxpayer contacts because it does not provide information about why eligible taxpayers do not use TeleFile or why they stopped using it.

Conclusion

The IRS can do more to meet Congressional intent to offer and improve TeleFile. We believe the IRS is partly moving away from Congressional intent by not offering TeleFile to all eligible taxpayers and by not obtaining sufficient information to overcome barriers that cause taxpayers not to use TeleFile. Increasing TeleFile use would reduce taxpayer burden including saving American taxpayers millions of dollars because TeleFile is cost free.

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Appendix I

Major Contributors to This Report

Walter E. Arrison, Assistant Inspector General for Audit, Wage and Investment Income Programs

Stanley C. Rinehart, Director

Richard J. Calderon, Audit Manager

John Kirschner, Senior Auditor

Larry A Mart, Senior Auditor

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Appendix II

Report Distribution List

Deputy Commissioner N:DC
Director, Electronic Tax Administration W:ETA
Director, Individual Electronic Filing W:E:IEF
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Chief Counsel CC
National Taxpayer Advocate TA
Office of Management Controls N:CFO:F:M
ETA Audit Liaison W:E:DEF:RA

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Appendix III

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

Taxpayer burden – Potential; an estimated 690,000¹ individual taxpayers would use TeleFile to file their returns if the Internal Revenue Service (IRS) were to reverse its decision to discontinue the TeleFile package mail-out for the two categories of taxpayers (see page 3).

Methodology Used to Measure the Reported Benefit:

The number of affected taxpayers is based on IRS estimates for the two categories of taxpayers that had, or will have, discontinued TeleFile packages.

¹ All volumes and estimates in this Treasury Inspector General for Tax Administration (TIGTA) report are based on IRS Electronic Tax Administration and Research Group (formerly known as the District Office Research and Analysis) documents without an independent verification by TIGTA.

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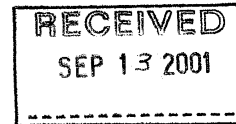
Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

September 13, 2001



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

John M. Dalrymple
John M. Dalrymple
Commissioner, Wage and Investment Division

SUBJECT:

The Treasury Inspector General for Tax Administration
(TIGTA) Draft Letter Report - The Internal Revenue Service
(IRS) is Contributing to the Decline in TeleFile
Volumes (Audit No. 200140002)

Thank you for the opportunity to respond to your recent report on the Office of Electronic Tax Administration's (ETA) TeleFile Program. As stated in the report, the overall objective of this audit was to evaluate whether the IRS is moving away from congressional intent by (1) not offering TeleFile to all eligible taxpayers, and (2) not obtaining sufficient information regarding the barriers that cause taxpayers not to use TeleFile.

Each year, we conduct focus group surveys and studies to determine the effectiveness of the TeleFile Program. The surveys are held nationwide by a contractor tasked to determine the reaction to the TeleFile package and identify reasons why eligible taxpayers were not using TeleFile. Unlike the surveys, the studies are conducted internally. Our Wage and Investment Research Group that specializes in analyzing filing patterns and trends performed several studies on the TeleFile usage and the program audience.

Both methods identified marketing strategies for enhancing TeleFile without impeding the intent of the IRS Restructuring and Reform Act of 1998 (RRA 98) for IRS to offer and improve the TeleFile Program. As a result, we have expanded the program beyond the Form 1040EZ filers by adding Form 4868, Extension of Time to File. For 2002, we will include three additional states in the Fed/State TeleFile Program. We will also target the TeleFile tax package to taxpayers that will use the program. This approach will reduce the mailing costs associated with the program by advising taxpayers, who no longer qualify for TeleFile, of other electronic filing options. We will also provide information on electronic signatures and free filing options to further reduce taxpayer burden.

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The following information is provided in response to the two recommendations in your report.

IDENTITY OF RECOMMENDATION/FINDING #1:

ETA management should reverse its decision to discontinue mailing TeleFile packages to the two categories of taxpayers based on the congressional intent for the IRS to offer and improve the TeleFile Program.

ASSESSMENT OF CAUSE:

ETA plans to discontinue mailing the TeleFile tax packages to (1) taxpayers whose prior year return had been prepared by paid preparers, and (2) taxpayers eligible to use TeleFile, but had not used it during the prior 2 years.

CORRECTIVE ACTION:

We intend to continue with the reduced TeleFile tax package mailout for the 2002 Filing Season. We based our decision to discontinue the TeleFile packages for (1) taxpayers whose prior year return had been prepared by paid preparers; and (2) taxpayers who had not used TeleFile for the prior 2 years on analysis performed by the Wage and Investment Research Group for Tax Years 1997, 1998, and 1999.

The results showed that discontinuing the mailing of 6.6 million TeleFile tax packages to taxpayers whose prior year return had been prepared by a paid preparer would not hinder the RRA 98 mandate. As stated in your report, to receive 330,000 returns, we would have to mail out 6.6 million tax packages at a cost of \$0.236 per package, which equates to \$1.6 million. We do not believe this is cost effective.

In addition, we do not believe that sending the TeleFile package out to taxpayers that had not used the program in the prior 2 years would result in program improvements. Based on the research findings, over 88 percent of taxpayers that received a TeleFile tax package for 3 years filed a paper return each year. The remaining 12 percent switched to TeleFile in the third year. To mail the TeleFile tax package out to these taxpayers for 3 years would cost \$2.4 million. Furthermore, we would only receive 400,000 additional TeleFile returns.

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IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

Commissioner, Wage & Investment Division W
Director, Electronic Tax Administration W:E
Director, Individual Electronic Filing Division W:E:IEF

IDENTITY OF RECOMMENDATION/FINDING #2:

The IRS should identify TeleFile eligible taxpayers not using TeleFile and eligible taxpayers who stopped using TeleFile. The IRS should then conduct targeted surveys of sufficient scope (sample sizes, geographical locations, and relevant questions) to determine the main barriers that prevent eligible taxpayers from using TeleFile. The information could then be used for specific outreach efforts to overcome the identified barriers.

ASSESSMENT OF CAUSE:

ETA conducts annual satisfaction surveys and focus groups with taxpayers that used TeleFile as well as those that chose another method for filing their return. The surveys and focus groups are conducted with a small number of taxpayers.

CORRECTIVE ACTION:

We have identified eligible taxpayers not using TeleFile and eligible taxpayers who stopped using TeleFile in Publication 3493, Tax Year 1999 Wage and Investment Research. Based on this identification, we conducted targeted surveys in four major cities across the United States. Participants included taxpayers that filed via TeleFile or a paper return as well as those taxpayers that used a paid preparer. Each participant was asked relevant questions to determine:

- (1) what prompted them to use TeleFile,
- (2) barriers associated with the program, and
- (3) recommended changes to the tax package and/or program.

The results supported analysis performed by our Research Group that ran several studies to identify similarities between users and non-users of the program. Each of these analyses was a major component in determining the scheduled improvements to the TeleFile Program for the 2002 Filing Season.

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IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

Commissioner, Wage & Investment Division W
Director, Electronic Tax Administration Division W:E
Director, Individual Electronic Filing Division W:E:IEF

If you have any questions, please contact Mary Ellen Corridore, at (202) 283-4893.